


**Government of the District of Columbia
Office of the Chief Financial Officer**



Natwar M. Gandhi
Chief Financial Officer

MEMORANDUM

TO: The Honorable Vincent C. Gray
Chair, Council of the District of Columbia

FROM: Natwar M. Gandhi
Chief Financial Officer 

DATE: June 21, 2010

SUBJECT: Fiscal Impact Statement: "Center Leg Freeway (Interstate 395)
PILOT and Air Rights Disposition Act of 2010"

REFERENCE: Bill 18-806

Conclusion

Funds are sufficient in the FY 2010 budget and the proposed FY 2011 through FY 2014 financial plan to implement the proposed legislation. However, as described below, the Office of the Chief Financial Officer has concerns about the precedent this PILOT structure may set for future development projects.

Background

Long-standing litigation regarding the District property and air rights adjacent to and above the I-395 depressed artery between Massachusetts Avenue and E Street, NW, the I-395 Air Rights, has delayed the sale and development of the site. In 2004, a court ruled that the District must pay Washington Development Group (WDG) \$8.4 million (plus interest) in reference to a previous disposition agreement. Both WDG and the District have appealed that decision.

The proposed legislation would give authority to the Mayor to move forward on the development of the site by authorizing a disposition to Louis Dreyfus Property Group (Dreyfus), who will be responsible for settling the litigation as a condition of disposition. Without a resolution of the litigation, it is unclear how long the current appeals process would take, what the cost of the final outcome of the litigation would be, or when the property would become available for development.

The proposed legislation approves the final disposition of District property and air rights adjacent to and above the I-395 depressed artery between Massachusetts Avenue and E Street, NW, including the disposition of Square 564, Lot 58 which houses an Office of the Chief

Technology Officer (OCTO) Shared Computer Center, and the property known as the Jewish Historical Society Synagogue located at 701 3rd Street, NW. Dreyfus would construct a deck over I-395, upon which a mixed-use development could be built.

The proposed legislation also approves the terms of the disposition, including the method for calculating the sales price payments from Dreyfus, which are based on a negotiated Development and Disposition Agreement, and the responsibility of Dreyfus to meet certain requirements including:

- complying with Federal Highway Administration (FHWA) requirements;
- paying for all costs associated with FHWA or District required environmental reviews, impact statements, traffic studies, security and engineering analyses;
- complying with the Small and Local Disadvantaged Business Enterprise Development and Assistance Act and First Source Agreements;
- entering into contracts with certain Certified Business Enterprises including: The Jarvis Company, LLC, Spectrum Management, and RJB Consulting Group;
- completing the deck over I-395 in a timely manner;
- developing 50 units of affordable housing; and
- obtaining the consent of WDG to dismiss the litigation currently associated with the I-395 Air Rights.

In addition, the proposed legislation approves a tax exemption and payment-in-lieu-of-taxes (PILOT) for Dreyfus. The PILOT period would begin as early as FY 2012 when the District transfers the air rights to Dreyfus, and would end the earlier of 10 years after the deck over I-395 is completed, or (on a parcel by parcel basis) upon issuance of a Certificate of Completion of Core and Shell of any building on the newly-created deck.

Finally, the legislation exempts all agreements resulting from this transaction, including those related to the disposition, contracting and construction, from the District of Columbia Procurement Practices Act.

Disposition Price

The draft Development and Disposition Agreement describes the process for determining the total sales price payments to the District as well as the timing of those payments. The payments are intended to create a fair market value, based on actual costs of construction of the deck, shared savings, and financial calculations and valuations that are made during the construction period. According to the draft Development and Disposition Agreement, the purchase price will be determined at a later date based on an appraisal adjustment model and actual costs. The price would never be lower than the District's current liability to WDG.

Because the purchase price is not yet determined, the OCFO cannot complete an analysis of whether actual payments to the District from Dreyfus will be greater or less than the value of the assets of which the District is disposing. However, because District assets are not part of the

District's operating budget, if the transaction results in a disposition price lower than the value of the property, there is no impact on the budget and financial plan.

The sale proceeds resulting from the disposition, after payments associated with settling the lawsuit with WDG, will be allocated between (i) an account designated by the District Department of Transportation (DDOT) for DDOT capital infrastructure expenses, and (ii) a reimbursement to OCTO for the costs of relocating the Shared Computer Center on the site. The OCFO previously identified the OCTO relocation as a cost of this transaction; however, the relocation has been funded within OCTO's budget. Through the transaction outlined in the proposed legislation, OCTO expects to be reimbursed for some or all of their relocation costs.

This disposition is not subject to the requirements of the District Land Disposition Amendment Act of 2009.

PILOT Payments

The legislation describes the PILOT as an amount equivalent to the real property taxes that would be otherwise levied on Class 1 Properties or Class 2 Properties (as applicable), based upon values described in the legislation and determined in accordance with the procedures contained in the documents governing the transfer of the real property, rather than on values assessed by the Office of Tax and Revenue.

The value of the I-395 Air Rights at the time of disposition is estimated to be approximately \$60 million¹. The legislation states that the disposition cannot occur prior to October 1, 2011 (FY 2012). Any PILOT made during FY 2012, FY 2013 and FY 2014, would be equal to the lesser of property taxes that would be owed based upon the assessed value of the site or property taxes that are projected to be owed based on OCFO projections in this fiscal impact statement.

Based on the project schedule, air rights appraisal, and estimated real property growth rates, the OCFO projects the following PILOT would be owed during the financial plan period.

Estimated Real Property Assessments and Real Property Tax for the I-395 Project				
	FY 2011	FY 2012	FY 2013	FY 2014
Projected Assessed Value	\$ 59,101,675	\$ 59,101,675	\$ 64,467,369	\$ 70,173,665
Projected Real Property Tax	\$0	\$ 1,087,381	\$ 1,186,646	\$ 1,292,213

After October 1, 2014 (beginning in FY 2015), Dreyfus would make PILOT based on a separate calculation of value made by the Mayor. These payments are expected to be significantly lower than what would otherwise be collected in property taxes for the site. Beginning in FY 2015, Dreyfus would receive a credit of up to \$5.4 million on its PILOT. Further, any PILOT due in FY 2015 and beyond, would accrue until the time a building permit is issued for the first vertical building above the I-395 deck.

¹ OTR estimate based on review of developer appraisals.

The timing of the completion of the deck and subsequent construction of buildings cannot be accurately projected. However, the District is unlikely to receive any PILOT payments between FY 2015 and FY 2020, a period during which the District would have expected over \$12 million in real property tax from the site. Because the deck is expected to be completed in phases, some buildings on the deck could reach Core and Shell Completion during this time and become taxable.

Concerns of the OCFO

The OCFO has two concerns about this PILOT structure, both of which appear to circumvent the fiscal impact process.

First, the District is giving significant subsidy to this project, but in order for this subsidy to have no fiscal impact, the legislation is granting this subsidy through reduced PILOT made subsequent to the financial plan period. An ongoing strategy to include subsidy in out-year budget periods will have a negative impact on the District's financial strength into the future.

Second, the PILOT includes a requirement that Dreyfus, during the financial plan period, make a PILOT equal to the lesser of what would otherwise be owed in taxes or what the OCFO today projects in the Fiscal Impact Statement would be owed in taxes. While this structure creates an agreement with no fiscal impact, it removes any possibility of the District benefiting from future economic conditions that are better than what is currently projected.

Financial Plan Impact

Funds are sufficient in the FY 2010 budget and the proposed FY 2011 through FY 2014 budget and financial plan to implement this legislation.